Supreme Court, U.S.
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No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

PHYLLIS KAHN and STEVEN G. THORNE,

Petitioners,

vs.

KOHLBERG, KRAVIS, ROBERTS & CO., a New York Limited Partnership, KKR ASSOCIATES, a New York Limited Partnership, and WHITEHALL ASSOCIATES, L.P., a Delaware Limited Partnership,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Since when Congress enacted § 214 of the Advisers Act, 15 U.S.C. 80b-14, it granted jurisdiction to federal courts to entertain only private suits in equity, did the court below err when it held that a legal statute of limitations should be applied to such actions?

2. Since this Court has held that the Investment Advisers Act of 1940, 15 U.S.C. § 80b-1, et seq. (the "Advisers Act") grants only a single cause of action to an investment advisor's client against his advisor, i.e., an action to void the advisory contract, did the court below err where it held that a uniform limitations period is needed because no single state limitations period may be consistently applied within a jurisdiction to such an action?

3. Since this Court has held that § 215 of the Advisers Act, 15 U.S.C. § 80b-15, implies only an equitable cause of action for rescission or similar relief, did the court below err when it held that a state law equitable action for rescission or similar relief is less analogous to an action under § 215 than an action at law seeking money damages for injury proximately caused by violations of federal securities laws?

4. Since this Court has held that the intent of Congress must be culled from events surrounding the passage of the Advisers Act in 1940, did the court below err when it applied the limitations period set forth in § 36(b) of the Investment Company Act, 15 U.S.C. § 80a-1, § 35(b) (the "Company Act"), enacted thirty years later in 1970?

5. Did the court below err when it held that the petitioners are barred by the statute of limitations from voiding a contract that calls for unlawful performance and the payment of unlawful compensation, where such performance and such payment have yet to be made?

6. Did the court below err when it held that the petitioners are barred by the statute of limitations from rescinding a contract that remains in force and that constitutes a continuing violation of the Advisers Act?

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KOHLBERG, KRAVIS, ROBERTS & CO., a New York Limited Partnership, KKR ASSOCIATES, a New York Limited Partnership, and WHITEHALL ASSOCIATES, L.P., a Delaware Limited Partnership,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered on June 30, 1992.

OFFICIAL AND UNOFFICIAL REPORTS OF OPINIONS OF COURTS BELOW

Kahn v. Kohlberg, Kravis, Roberts & Co., et al., [Current] Fed. Sec. L. Rep. (CCH) ¶ 96,889 (2d Cir. 1992); [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,407 (S.D.N.Y. 1991).

STATEMENT OF JURISDICTION

The jurisdiction of this Court is invoked by petition for writ of certiorari to the United States Court of Appeals for the Second Circuit pursuant to 28 U.S.C. § 1254(1) for the review of a final judgment, dated June 30, 1992.

The jurisdiction of the district court was based upon §§ 201 through 222 of the Advisers Act, 15 U.S.C. § 80b-1 through 80b-21, and in particular, §§ 214 and 215, thereof, 15 U.S.C. §§ 80b-14 and 80b-15. The complaint alleged that the defendants failed to register as

investment advisers, in violation of § 203 of the Advisers Act, 15 U.S.C. § 80b-3, entered into unlawful compensation agreements, in violation of § 205, U.S.C. § 80b-5, and failed to disclose material facts, in violation of § 206, 15 U.S.C. § 80b-6.

RELEVANT STATUTES

Investment Advisers Act of 1940, Sections 203, 205, 206, 214, 215 (15 U.S.C. §§ 80b-3, 80b-5, 80b-6, 80b-14, 80b-15), the text of which are set forth in the Appendix submitted herewith.

STATEMENT OF THE CASE

Plaintiffs commenced this derivative action in the United States District Court for the Southern District of New York on behalf of The Basic Retirement Funds, by their trustee, The Minnesota State Board of Investment (the "State

Board") and on behalf of Whitehall Associates, L.P. ("Whitehall"), a limited partnership of which the State Board is a limited partner. Plaintiffs served an amended complaint on September 30, 1991.

The complaint alleges that pursuant to an agreement between defendant Kohlberg, Kravis, Roberts & Co. ("KKR"), on the one hand, and the State Board and seventy-seven additional entities (the "Participants") on the other, KKR acts as an investment adviser to the State Board, to each of the other Participants, to Whitehall, and to other limited partnerships that KKR creates as vehicles for the investments that it recommends.

The complaint further alleges that KKR has violated and continues to violate the Advisers Act by failing to register as an investment adviser, and by

receiving, both directly and indirectly, compensation that is prohibited under the Advisers Act.

KKR and its affiliate, KKR Associates, and Whitehall moved to dismiss the complaint pursuant to Rules 12(b)(6) and 12(b)(7) of the Federal Rules of Civil Procedure. The district court granted defendants' motion, in an opinion and order dated November 18, 1991, on the ground that the claims asserted by plaintiffs were barred by the statute of limitations.

Petitioners filed their Notice of Appeal to the United States Court of Appeals for the Second Circuit on December 13, 1991. On June 30, 1992, the Second Circuit entered its judgment affirming the district court's judgment of dismissal.

In reaching its decision, the court below determined that the interests of certainty and judicial economy supported the adoption of a uniform statute of limitations for suits under the Advisers Act. The court then determined that statutes of limitations applicable to private causes of action for violations of the federal securities laws other than the Advisers Act provided a closer fit for a private cause of action for rescission under § 215 than state law limitations periods applicable to actions for rescission. Specifically, the court below held that either the one-year period found in Section 36(b) of the Company Act, or the one-year and three-year period found in both the Securities Act of 1933 (the "1933 Act"),[1] and in the

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[1] 15 U.S.C. §§ 77a, et. seq.

Securities Exchange Act of 1934 (the "1934 Act")[2] was applicable to actions under the Advisers Act.

The court below then found that under either statute, all of plaintiffs' claims were time-barred.

STATEMENT OF FACTS

A. Identification Of The Parties.

Plaintiff Phyllis Kahn ("Kahn") is a member of the House of Representatives of the State of Minnesota, and a Minnesota citizen and taxpayer. She is the chairperson of the committee of the House, which has oversight authority over the State Board, including fees paid by the State Board to investment advisers. Plaintiff Kahn commenced this action both in her capacity as a legislator and as a

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[2] 15 U.S.C. §§ 78a, et. seq.

taxpayer of the State of Minnesota.[3]

Plaintiff Steven G. Thorne ("Thorne") was Deputy Commissioner of the Minnesota Department of National Resources until January 21, 1991, and he is alleged to be a participant in a pension plan managed by KKR.

The State Board manages the pooled assets of the currently working participants in eight Minnesota state employee retirement funds (the "Pension"), and serves as trustee for the benefit of the contributors to the Pension.

Defendant KKR is a limited partnership that manages the retirement funds of millions of state and local

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[3] Minnesota recognizes the standing of taxpayers to commence actions on behalf of state and local governmental authorities to challenge the unlawful expenditures of public monies.

employees. Despite the fact that KKR is an investment adviser that manages and invests billions of dollars of pensioners' funds in speculative leveraged buyouts and other investments, and meets every criterion for registration under the Advisers Act, it has failed to register.[4]

KKR raises capital for its investments by aggressively soliciting new clients. These clients, by letter agreement, commit for a six-year period to invest a specific amount with KKR. KKR terms this collection of investors, or participants, a fund. In the instant

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[4] In a request for a no-action letter to the Securities Exchange Commission ("SEC"), dated July 23, 1985, reprinted at [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,143 at 76,634, KKR conceded that it was an investment adviser, but argued that it was exempt from registration because it had fewer than fifteen clients.

case, the State Board and the other Participants retained defendant KKR pursuant to the terms of a commitment letter dated as of September 25, 1987 (the "Commitment Letter").

Investors do not invest directly into the fund, which is merely a "term of convenience", but rather, invest in limited partnerships created by KKR once it has identified investments. Whitehall is such a limited partnership. Defendant KKR Associates, a New York limited partnership owned or controlled by KKR, is the general partner of Whitehall.

B. Terms Of The Commitment Letter.

Pursuant to the terms of the Commitment Letter, the State Board agreed, when called upon, to contribute up to $146,643,660 to a prospective partnership. The aggregate amount

committed by the Participants was $5.6 billion. The Commitment Letter provided that, so long as the sum of unused commitments exceeded $150 million, each Participant would pay to KKR 1.5% of its maximum commitment. Such fee, in the aggregate, amounts to $86 million per year.

In return for these fees, KKR agreed to "seek out", "identify", "evaluate", and "select" appropriate enterprises, or parts thereof, in which the Participants were to invest, and to "monitor" and "supervise" the "management" and "operations" of the selected investment. KKR also agreed to determine when the investment should be sold.

C. The RJR Nabisco Transaction.

In or about March, 1989, KKR selected an investment for the State

Board and the other Participants -- RJR Nabisco, Inc. ("RJR"), and created Whitehall as the vehicle to fund the acquisition. The State Board and the other Participants were called upon to contribute their commitments and became limited partners of Whitehall. On April 28, 1989, the acquisition of RJR was completed (the "RJR Acquisition"), when RJR was acquired by a wholly-owned subsidiary of a corporation created by KKR for the transaction, RJR Holdings Corp. ("RJR Holdings"). Whitehall, at that time, owned 90% of the common stock of RJR Holdings.

Since the date of the RJR Acquisition, KKR has misused its complete control over Whitehall, RJR Holdings and RJR, to enter into excessive and unlawful compensation agreements, pursuant to

which KKR, its partners and employees, in addition to the $86,000,000 annual fee noted above, will receive the following fees, directly or indirectly, from Whitehall and its limited partners:

a. Fees of $75,000,000 for investment banking services purportedly performed in connection with the RJR Acquisition;

b. Fees of $10,000,000 in each of 1989 and 1990, paid by RJR Holdings allegedly for managing its business;

c. Annual directors' fees of $50,000 received by each of seven KKR partners and employees; and

d. A fee (estimated to be $600,000,000) equal to twenty

percent (20%) of Whitehall's profits upon the sale of RJR.

None of these fees were set forth in the Commitment Letter or were part of that agreement.

D. Defendants' Continued Performance Of The Contracts At Issue And Continued Violations Of The Law.

The contracts at issue remain in force, and KKR and KKR Associates continue to perform investment advisory services pursuant to them. They purport to monitor and supervise the operations of RJR, and assess information with respect to the determination as to when RJR should be sold.

KKR continues to be compensated for its continuing services, and stands to receive its percentage of capital gains when RJR is sold. Thus, the advisory agreements at issue remain executory both

as to performance and payment.

E. The Complaint.

The complaint alleges that as a result of its rendering of investment advice to the State Board and Whitehall, KKR and KKR Associates have acted as investment advisers, and have violated, and continue to violate the Advisers Act, at least by (a) failing to register, in violation of § 203, (b) entering into and performing advisory contracts with the State Board and Whitehall which provide for compensation on the basis of a share of capital gains or appreciation, in violation of § 205, and (c) failing to make full disclosure with respect to their compensation, in violation of § 206.

Plaintiffs bring this action both directly, and on behalf of the Pension,

and derivatively on behalf of Whitehall.

ARGUMENT

Section 215 of the Advisers Act provides a limited implied right of action to clients of investment advisors, i.e., an action in equity to void the advisory contract. Although Congress did not provide any limitations period for such action, the court below determined that a statute of limitations should be applied, and, purporting to utilize the hierarchical inquiry most recently articulated by this Court in Lampf Pleva Lipkind, Prupis & Petigrow v. Gilbertson,[5] determined that such statute of limitations should be borrowed from federal, not state law. Specifically, the court below determined either that

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[5] ___ U.S. ___, 111 S.Ct. 2773 (1991).

the one-year period found in § 36(b) of the Company Act, or the one-year and three-year period found in the 1933 Act and 1934 Act, was applicable to actions under the Advisers Act.

Petitioners submit that at each step of the inquiry outlined by Lampf, the court below took a wrong turn. There is no need for a uniform limitations period for actions under § 215. Further, it was erroneous to apply the legal statute of limitations periods found in the 1933 Act and 1934 Act to the exclusively equitable action for rescission under § 215. It was even greater error to apply to a statute enacted in 1940, a limitations period enacted in 1970 in a companion statute.

Finally, the determination of the court below that the statute of

limitations had run, while performance and payment under the contract remained executory, was also erroneous. Accordingly, petitioners submit, the Court of Appeals has decided an important question of federal law which has not been, but should be settled by this Court, and which conflicts with decisions of this Court.

I. THE COURT BELOW APPLIED AN ERRONEOUS PERIOD.

Petitioners have brought this action pursuant to § 215 of the Advisers Act. In Transamerica Mortgage Advisors, Inc. v. Lewis,[6] this Court held that such provision implies a limited cause of action against an investment adviser by its client:

> "[W]e conclude that when Congress declared in § 215 that certain

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[6] 444 U.S. 11, 19 (1979).

> contracts are void, it intended that the customary legal incidents of voidness would follow, including the availability of a suit for rescission or for an injunction against continued operation of the contract, or for restitution."

In Transamerica, this Court expressly rejected the proposition that the Advisers Act implied any cause of action apart from that articulated above. This Court emphasized that the statute, as enacted by Congress, omitted any reference to "liability" or "actions at law", and therefore concluded:

> "For the reasons stated in this opinion, we hold that there is a limited private remedy under the Investment Advisers Act of 1940, to void an investment advisers contract, but that the Act confers no other private causes of action, legal or equitable."[7]

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[7] In 1990, § 214 was amended to grant courts jurisdiction to hear "actions at law". The legislative history of that amendment states that the amendment was enacted to enable the district courts to determine actions for

Because the Advisers Act is silent as to what statute of limitations, if any, is applicable to private claims asserted under § 215, the court below was called upon to determine the appropriate limitations period to be applied in this action.

A. The Court Misconstrued The First Step Of The Hierarchical Inquiry. No Uniform Statute Of Limitations Is Needed.

When determining whether to depart from the normal state-borrowing doctrine, the first question to be answered is whether the "federal cause of action tends in practice to 'encompass numerous

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civil penalties brought by the Securities and Exchange Commission. There is nothing in that history that suggests that such amendment expanded the remedies available to private litigants or permitted them to bring actions at law for damages. See House Report No. 101-616, 101st Cong., 2d Sess. (1990), reprinted at 1990 U.S. Code Cong. and Adm. News, p. 1379.

and diverse topics and subtopics' such that a single state limitations period may not be consistently applied within a jurisdiction", so that a uniform statute of limitations is necessary.[8] The court below answered this question in the affirmative, opining that a claim under § 215 could be "analogized" to numerous and different causes of action, including "a violation of state securities regulations or the state professional code, common law breach of contract, fraud, or an action for rescission." (A-11) It therefore held that application of a single limitations period within any state would be uncertain, and that a uniform period was necessary.

The court's determination that a single limitations period may not be

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[8] Lampf, 111 S.Ct. at 2799.

applied to the lone form of action implied by § 215 is baffling, and irreconcilable with this Court's decision in Transamerica. At common law, it is elementary that conduct may give rise to more than one form of action -- e.g., a claim sounding in tort and a claim sounding in contract -- and may entitle a plaintiff to more than one form of relief -- e.g., damages at law or equitable relief.[9] In such an instance, the limitation period to be applied may arguably depend upon the form of the action asserted.

Such a circumstance is not presented in a private action under § 215. That section creates no "liability"; it provides no private action for damages.

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[9] See Prosser and Keaton, The Law of Torts, Chapter 16 (5th Ed. 1984).

The plaintiff is not free to "elect" his remedy, and the court possesses no "concurrent jurisdiction" to determine mixed questions of law and equity. Thus, if an investment advisor defrauds its client, or converts its funds, or breaches any regulation or professional code, under § 215, the client cannot elect to sue in tort. Instead, he is restricted to one form of action and one form of relief -- to void the advisory contract, and obtain rescission.

Accordingly, it is plain that a court would have no difficulty in applying a single limitations period -- or laches -- to this single form of action. Courts of New York, the jurisdiction at issue in this litigation, have had no such difficulty applying a single limitations period to actions for

rescission, even though the "bases" for such actions may have differed.[10] No uniform statute is needed at the federal level.[11]

B. The Court Misconstrued The Second Step. A State Statute Should Have Been Borrowed.

The second issue identified by this Court in Lampf if a uniform limitations period is deemed to be appropriate, is whether this period should be derived

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[10] Loengard v. Santa Fe Industries, Inc., 70 N.Y.2d 262, 519 N.Y.S.2d 801, 803, 514 N.E.2d 113 (1987) (Unjust enrichment); Greene v. Greene, 56 N.Y.2d 86, 451 N.Y.S.2d 46, 436 N.E.2d 496 (1982) (Fraud); Van Dussen-Storto Motor Inn v. Rochester Tel. Corp., 63 A.D.2d 244, 407 N.Y.S.2d 287 (4th Dep't 1978) (Duress).

[11] The court below mistakenly stated that plaintiffs requested a uniform period be applied. In fact, plaintiffs only requested the court to apply the New York limitations period for actions for rescission. However, because § 215 provides only one form of action, application of state statutes might result in a de facto uniform statute.

from a state or a federal source. This Court noted that federal borrowing is a "closely circumscribed exception", and stated that in making its judgment, a court should accord weight to the geographic character of the claim and to whether an analogous federal source "truly affords a 'closer fit' to the cause of action at issue than does any available state-law source".[12]

The court below determined that claims under § 215 are multistate, stating that violations could occur in numerous states. Further, the court below held that "the elements of a § 215 claim are more similar to claims under the Securities Acts" than claims at common law. (A-13) Accordingly, the court below held that federal borrowing

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[12] 111 S.Ct. at 2778-2779.

was appropriate. In both instances, the court below was in error.

1. Section 215 Actions Are Not Multistate.

In determining that actions under § 215 are multistate in nature, the court below, once again, failed to recognize the limitations placed upon the nature and scope of such actions as delineated by this Court. An action under § 215 is not multistate in the manner of an action under Rule 10b-5 or RICO.

Courts today recognize that the latter actions may be nationwide in scope, involving the same misrepresentations made to thousands of investors. The potential complexity of a Rule 10b-5 action and its effect on the determination of a proper state law limitations period was aptly described in

Davis v. Birr, Wilson & Co., Inc.,[13] wherein it was noted that a Rule 10b-5 action might involve a "broker in Phoenix, an issuer in San Francisco, a purchaser in Montana, an accountant in Portland, and a lawyer in Honolulu". Absent a uniform statute of limitations period, a court in such an instance might be presented with a crazy-quilt of potentially applicable limitations periods. The same might be true in a RICO action, which by its terms, requires a "pattern of racketeering activity".

By contrast, because a lawsuit under § 215 is limited to an action between the parties to a contract to void it, neither the potential for multiparty or multidistrict litigation, as in Rule 10b-

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[13] 839 F.2d 1369, 1375 (9th Cir. 1988) (Aldisert, J., concurring).

5 actions, nor the potential for much forum-shopping is present in § 215 cases.

While it is true, as the court below noted, that parties to an advisory contract may come from different states, or that clients from different states seeking to rescind similar contracts may be subject to different limitations periods, this is true of every contract action, and hardly warrants departure from the normal state-borrowing mechanism. As this Court stated in an analogous "contract" action, International Union, United Automobile, Aerospace and Agricultural Implement Workers of America (UAW), AFL-CIO v. Hoosier Cardinal Corporation:[14]

> "It is true that if state limitations provisions govern § 301 suits, these suits will lack a

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[14] 383 U.S. 696, 701-703 (1966).

> uniform standard of timeliness. . . . Lack of uniformity [however] is unlikely to frustrate in any important way the achievement of any significant goal of labor policy. Thus, although a uniform limitations provision for § 301 suits might well constitute a desirable statutory addition, there is no justification for the drastic sort of judicial legislation that is urged upon us."

Accordingly, no uniform period is necessary.

2. Section 215 Actions Are Analogous To Actions At Common Law.

Equally untenable to the above conclusion is the determination of the court below that an action for rescission under § 215 resembles less an action at common law for rescission than an action under the antifraud provisions of the securities laws or Section 36(b) of the Company Act, and thus warrants a departure from the "usual" state-borrowing rule.

This Court has departed from that rule on only a few occasions, and only in instances that involved anomalous federal statutory actions that had no counterpart at common law.

Thus, in DelCostello v. International Brotherhood of Teamsters,[15] the court was required to determine the limitations period applicable to a union member's claim against his union for breach of the union's duty of fair representation in a grievance proceeding, pursuant to Section 301 of the Labor Management Relations Act. There, the court examined state law actions for breach of contract, to vacate an arbitration award, and for legal malpractice, before rejecting each, and determining that the "hybrid § 301/fair

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[15] 462 U.S. 151 (1983).

representation claim" has "no close analogy in ordinary state law".[16]

In Agency Holding Corp. v. Malley-Duff & Assoc., Inc.,[17] the claim for relief was based upon violations of RICO. In borrowing the four-year statute of limitations from the Clayton Act, rather than from state law, the court not only relied upon the fact that "concepts such as RICO 'enterprise' and 'pattern of racketeering activity' were simply unknown at common law", but also, upon the fact that it was "the clear legislative intent to pattern RICO's civil enforcement provision on the Clayton Act".[18]

The factors present in DelCostello

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[16] 462 U.S. at 162.

[17] 483 U.S. 143 (1987).

[18] 483 U.S. at 149, 152.

and Agency Holding Corp. are nowhere present in this action. Section 215 of the Advisers Act, rather than creating a cause of action unknown at common law, merely codified a cause of action that was well established therein. As this Court stated in Transamerica when enacting § 215, Congress "intended that the customary legal incidents of voidness would follow".[19]

Indeed, this Court in Transamerica, found the right of action in § 215 to be so analogous to state law causes of action for rescission, that it even posited the "possibility that Congress intended that claims under § 215 would be raised only in state court".[20]

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[19] 444 U.S. at 19, Emphasis added.

[20] 444 U.S. at 19 n.8, Emphasis added.

The court below failed to explain how an action that is "customary" and "ordinary"[21] at common law could be so exceptional as to require resort to federal law to determine the statute of limitations.

The Court of Appeals not only ignored the obvious parallels between a state court action for rescission and a federal statutory action for rescission, but it also ignored the fact, emphasized by this Court in Transamerica, that the Advisers Act only permits private actions in equity.

In Russell v. Todd,[22] this Court expressly distinguished between instances where the plaintiff has concurrent actions at law and in equity, and where

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[21] 444 U.S. at 18.

[22] 309 U.S. 280 (1940).

the plaintiff's remedy sounds exclusively in equity. There, this Court stated:

> "Even though there is no state statute applicable to similar equitable demands, when the jurisdiction of the federal court is concurrent with that of law, or the suit is brought in aid of a legal right, equity will withhold its remedy if the legal right is barred by the local statute of limitations. It thus stays its hand in aid of a legal right which, under the Rules of Decision Act, would be unenforcible in the federal courts of law as well as in the state courts.
>
> But where the equity jurisdiction is exclusive and is not exercised in aid or support of a legal right, state statutes of limitation barring actions at law are inapplicable, and in the absence of any state statute barring the equitable remedy in like cases, the federal court is remitted to and applies the doctrine of laches as controlling."[23]

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[23] 309 U.S. at 289 (Citations omitted). See also, Nemkov v. O'Hare Chicago Airport Corp., 592 F.2d 351, 354 (7th Cir. 1979).

In Holmberg v. Armbrecht,[24] the court determined that in cases involving actions only in equity, federal courts were not even bound to follow statutes of limitations for equitable actions, stating:

> "When Congress leaves to the federal courts the formulation of remedial details, it can hardly expect them to break with historic principles of equity in the enforcement of federally-created equitable rights."

In this instance, the cause of action created by Congress when it enacted the Advisers Act in 1940 was equitable. Congress created no concurrent legal right. Accordingly, Congress can hardly have expected the courts to "break with historic principles of equity" and apply a legal statute of limitations. Yet that is precisely what

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[24] 327 U.S. 392, 395 (1946).

the court below did. Accordingly, its decision should be reversed.

II. NEITHER THE LIMITATIONS PERIOD UNDER SECTION 36(b) OF THE COMPANY ACT NOR THOSE SET FORTH IN THE 1933 AND 1934 ACTS SHOULD BE APPLIED.

Having improperly determined that a uniform limitations period should be selected, and that no state law cause of action was analogous to § 215, the court below compounded its error by selecting the limitations periods set forth in § 36(b) of the Company Act, and in the 1933 and 1934 Acts.

Neither of these periods was appropriate for application to § 215, as set forth below.

A. The Limitations Period Under § 36(b) Of The Company Act Should Not Be Applied.

When Congress is silent as to the statute of limitations applicable to a

cause of action, it is not the function of the judiciary to select, on its own, a limitations period which in its own subjective view might be most appropriate.

As this Court has repeatedly and unwaveringly held in case after case, the role of any court when deciding which limitations period to apply to a claim is not to legislate its own statute of limitations, but rather, to determine the "expectations of Congress", i.e., what Congress intended when it created the cause of action at issue.[25] As was observed in Lampf, for a court to "'imply' an appropriate statute of limitations" without reference to the

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[25] Lampf, 111 S.Ct. at 2778, 2780; DelCostello, 462 U.S. at 158-59; Agency Holding Corp., 483 U.S. at 152-153; Wilson v. Garcia, 471 U.S. 261, 266-76 (1985).

intent of Congress "would be too lawless to be imagined".[26]

Nonetheless, by selecting the one-year limitations period applicable to Section 36(b) of the Company Act, and applying it to actions under § 215, the court below engaged in just such "lawless" activity.

Congress enacted § 215 in 1940; it enacted § 36(b) in 1970. It would seem beyond dispute that when it passed the Advisers Act and created the right of action under § 215, Congress cannot have intended to apply a statute of limitations that it was not to enact for another thirty years.

Nonetheless, if the court below required judicial support for this self-

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[26] 111 S.Ct. at 2783 (Scalia, J., concurring).

evident proposition, it need have looked no further than this Court's decisions interpreting the Advisers Act. Thus, in Securities Exchange Commission v. Capital Gains Research Bureau, Inc.,[27] this Court expressly rejected the argument that amendments enacted in 1960 can be analyzed to determine the intent of Congress when it enacted the Advisers Act in 1940, stating:

> "[T]he intent of Congress must be culled from the events surrounding the passage of the 1940 legislation. '[O]pinions attributed to a Congress twenty years after the event cannot be considered evidence of the intent of the Congress of 1940.'"

This Court reiterated such rule in Transamerica.[28] Most recently in Lampf,

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[27] 375 U.S. 180, 199-200 (1963). Citations omitted.

[28] 444 U.S. at 22 n. 13. Indeed, in Transamerica, this Court found it significant that, in 1970, no provision comparable to § 36(b) had been added to

this Court made clear that the court below was required to demonstrate some basis for concluding that Congress, when it passed § 36(b) in 1970 of the Company Act, intended to apply its shorter limitations period to the pre-existing cause of action under § 215 as well.[29] The court below articulated no such basis.

The Court of Appeals excused this ex post facto application of § 36(b) by stating that "as pointed out in DelCostello, the Court need not determine that Congress had the specific intent to apply the borrowed period." (A-15; emphasis added; footnote omitted.) Even

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the Advisers Act.

[29] Lampf, 111 S.Ct. at 2781 ("There is no indication that the drafters of § 20A sought to extend that enhanced protection to other provisions of the 1934 Act").

assuming that this is a correct reading of DelCostello (which it is not),[30] it still begs the question. Even if the Court does not have to find a "specific intent" in order to avoid "judicial legislation", it still must find that such intent was "possible". However, unless Congress was clairvoyant in 1940, such a possibility could not have existed.

In addition, the unique nature of § 36(b), standing alone, makes it clear that that statute, which "create[d] an

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[30] In DelCostello, this Court held that there is no need to show that when Congress enacted a limitations period for one action, that it intended such period to apply to another contemporaneously or subsequently enacted statutory cause of action. 462 U.S. at 169 n. 21. This does not mean, however, that a court need not demonstrate some intent by Congress, when enacting the latter provision, to borrow limitations period from the former.

entirely new right," was not intended to apply to suits such as this, by a client against its adviser. As this Court has noted, § 36(b) of the Company Act created "an unusual cause of action" which differs significantly from those traditionally asserted in shareholder derivative suits.[31]

Further, support of the securities industry for the provisions of § 36(b) was obtained only by the addition of § 36(b)(3). As one court has noted, the limitations contained in that subsection, which include the limitation of damages to those sustained during the period beginning one year prior to initiation of suit (discussed in Senate Report No. 184, 91st Cong., 1st Sess. (1969)), "seem to

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[31] Daily Income Fund, Inc. v. Fox, 464 U.S. 523, 541 (1984).

have been an integral part of the trade off which gained the industry's support for more vigorous court review of adviser compensation".[32] The limitations period provided in § 36(b)(3) is tied to the expansion of existing remedies which § 36(b) provided.

Thus, § 36(b) is sui generis in a number of respects, and its limitation period should not be applied herein.

B. The One Year/Three Year Limitations Period Contained In The 1934 And 1933 Acts Should Not Have Been Applied.

In the court below, plaintiffs argued that the statute of limitations applicable to private causes of action for violations of the 1933 and 1934

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[32] Taylor v. Paine Webber Cashfund, Inc., 559 F.Supp. 429, 436 (D. Conn. 1983).

Acts[33] are not appropriate in the instant case. All of such sections apply to a sale of securities, and involve some sort of misrepresentation or other fraud. In contrast, in this case, the claims alleged assert an equitable action for rescission of a service contract, and are totally dissimilar to those to which the one-year/three-year limitations period has been Congressionally (and judicially[34]) applied.

The court below however, rejected the plaintiffs' argument, finding that the purposes behind the Advisers Act and the 1933 and 1934 Acts are almost identical, and that there is a similarity between certain of the Advisers Act and

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[33] E.g., § 13 of the 1933 Act, 15 U.S.C. § 77m.

[34] See, Lampf, supra.

"the 1933 and 1934 Act claims". (A-17-A-18) In so concluding, however, the court below failed to recognize that although there is some overlap between the Advisers Act and the 1933 and 1934 Acts, the Advisers Act goes far beyond the earlier legislation.

Although the Advisers Act is directed at the elimination of fraud and misrepresentation, it is also designed to ensure that investment advisers fulfill "their fiduciary obligations to their clients".[35] As this Court has stated:

> "[T]he Committee Reports indicate a desire to preserve 'the personalized character of the services of investment advisers,' and to eliminate conflicts of interest between the investment adviser and the clients as safeguards both to 'unsophisticated investors' and to 'bona fide investment counsel.' The Investment Advisers Act of 1940 thus

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[35] S.E.C. v. Capital Gains, 375 U.S. at 189-190 (1963).

> reflects a congressional recognition 'of the delicate fiduciary nature of an investment advisory relationship,' as well as a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser - consciously or unconsciously - to render advice which was not disinterested."[36]

Thus, although as the court below found, one purpose of the Advisers Act is to avoid "frauds", the fraud encompassed by that statute is quite different from the fraud which the 1933 and 1934 Acts were designed to redress.

Recognizing that "[f]raud has a broader meaning in equity [than at law]", in construing the Advisers Act, this Court stated that the doctrines of fraud and deceit which had developed around transactions involving tangible items of wealth are "ill-suited" to the sale of

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[36] Id. at 192.

investment advice. Concluding that such doctrines "must be adapted to the merchandise in issue", this Court held that fraud, as contemplated by the Advisers Act, does not necessitate intent and injury, and that accordingly, neither is an essential element of a suit under that Act.

The fraud regulated by the Advisers Act is not the same as that regulated by the 1934 Act. In Santa Fe Industries, Inc. v. Green,[37] this Court expressly rejected the argument that a breach of fiduciary duty constituted fraud under the 1934 Act, as well as the application of a "federal fiduciary principle" under Rule 10b-5. The reasoning of the court in Santa Fe was reiterated in the case of

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[37] 430 U.S. 462 (1977).

Schreiber v. Burlington Northern, Inc.[38] with respect to Section 14(e) of the 1934 Act.

It would appear obvious that Congress, when it enacted the securities laws, intended the statute of limitations provided therein to apply to the type of fraud with which those statutes dealt. The fact that Congress, when it enacted those laws, intended the one-year, three-year rule to apply only to claims of non-fiduciary fraud, is confirmed by the language of one statute relied upon by the court below, Section 29[39] of the 1934 Act, which is virtually identical to the language of Section 215.

As originally enacted, Section 29 contained no statute of limitations.

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[38] 472 U.S. 1, 7-8 (1986).

[39] 15 U.S.C. § 78cc.

However, it was amended to provide a one-year, three-year period for actions based upon violations of Section 15, an antifraud provision, but not for any other violations of the 1934 Act. Under the familiar doctrine, inclusio unius est exclusio alterius, it is logical to infer that had Congress intended the § 29 limitations period to be applied to actions for rescission, it would have said so.

The illogic of applying a non-fiduciary antifraud limitations period to claims of breach of fiduciary duty under § 215 of the Advisers Act is no more evident than in this action. Plaintiffs have not alleged any conduct cognizable as fraud under either the 1933 or 1934 Acts. Accordingly, application of statutes of limitation from those

statutes is highly inappropriate in this case.[40]

III. BY APPLYING FRAUD PRINCIPLES TO AN EQUITABLE ACTION FOR RESCISSION OF A CONTRACT, THE COURT BELOW UNDERMINED THE PURPOSE OF THE INVESTMENT ADVISERS ACT.

Plaintiffs argued below that their action was not time barred, irrespective of the statute of limitations selected by the court, because under recognized exceptions to the general rule, such statute had not yet run. The exceptions applicable in this action were based on:

1. The ongoing performance of advisory services by KKR, in violation of the Advisers Act, which constituted a

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[40] The only other provision enacted in 1940 containing a comparable fiduciary principle was § 36 of the Company Act. Plaintiffs suggested to the court below that if it had to apply any federal limitations period, it should apply the five year period set forth therein.

continuing wrong;

2. The executory nature of the contract, performance of whose terms was not yet complete; and

3. The fiduciary relationship between the parties.

Using distorted logic, the court below erroneously rejected all of the aforesaid exceptions, each of which will be separately discussed below.

A. The Court Below Erred In Applying A Fraud Concept To A Continuing Wrong.

In Hanover Shoe, Inc. v. United Shoe Machinery Corp.,[41] this Court distinguished between "a violation which . . . must occur within some specific and limited time span" and "conduct which constitute[s] a continuing violation of [a federal statute] and which inflict[s]

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[41] 392 U.S. 481 (1968).

continuing and accumulating harm on" the plaintiff. In this case, the court below refused to make that distinction.

Plaintiffs argued that this action is not barred because the ongoing rendition of investment advice by KKR has constituted a continuing violation of the Advisers Act which has inflicted continuing and accumulating harm on the Pension and Whitehall. The Pension and Whitehall have, since the inception of their contract with KKR, been deprived of the protection conferred by the requirement of registration, have paid indirectly, unlawful fees for the ongoing advice received, and have incurred, and will continue to incur liability for additional fees.

In applying the continuing wrong theory, the courts have looked to the

ongoing course of conduct on the part of the defendant and its impact in later years. Thus, for example, in Berkey Photo, Inc. v. Eastman Kodak Co.,[42] the court held that conduct which occurred before the four year limitations period could satisfy the conduct requirement of the Sherman Act. The court held that "a monopolist that has established its dominant position by unlawful conduct [can be prevented] from exercising that power in later years to extract an excessive price". The court stated that "[t]he taint of an impure origin does not dissipate after four years if a monopolist continues to extract excessive prices because of it". Plaintiffs contended that in this case, the "taint"

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[42] 603 F.2d 263, 296 (2d Cir. 1979), cert. denied, 444 U.S. 1093 (1980).

of KKR's unregistered status at the time the Commitment Letter was executed did not dissipate after three years,[43] since KKR continues to act as an investment adviser to the Pension and Whitehall pursuant to that agreement, in violation of the Advisers Act.

The court below, however, refused to recognize the ongoing performance of the unlawful agreement as a continuing wrong. Instead, the court deemed appropriate to this case, the "commitment theory", which has been held applicable to fraud in connection with a "purchase or sale within the meaning of Rule 10b-5". In Rule 10b-5 cases, the sales transaction has been held to have occurred when the parties thereto "were committed to one

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[43] See, e.g., United States v. Guerlter, 147 F.2d 796 (2d Cir.), cert. denied, 325 U.S. 879 (1945).

another",[44] even if there had not been "a formal exchange of money".[45] The artificial definition of a sale under 10b-5 was designed to effectuate "[t]he essential purpose" of the Rule, i.e., "to prevent corporate insiders and their tippers from taking unfair advantage of the uninformed outsiders" and "beat[ing] the news" by obtaining immediate execution of a trade before an outsider could act on a major news release.[46]

The application by the court below of a theory specifically devised in order

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[44] Department of Economic Development v. Arthur Andersen & Co., 683 F.Supp. 1463, 1475 (S.D.N.Y. 1988).

[45] Radiation Dynamics, Inc. v. Goldmuntz, 464 F.2d 876, 891 (2d Cir. 1972).

[46] Securities and Exchange Commission v. Texas Gulf Sulfur Co., 401 F.2d 833, 853, fn. 17 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969).

to effectuate a fraud statute aimed at a discrete, "one-shot" sales transaction, to the ongoing performance of a service contract in violation of the Advisers Act, makes no sense, and undermines the statutory purpose. Much more appropriate is the continuing wrong theory which acknowledges that the failure to stop the continuing violation of a statute would make enforcement of such statute "a futile thing".[47] Thus, as the court recognized in Berkey Photo v. Eastman Kodak Co., an anti-trust action, "[i]t would undercut enforcement of the Sherman Act to hold that, if a monopolist merely retains its illicit market control for four years after its last anticompetitive action, it may charge an exorbitant price

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[47] Schine Chain Theatres, Inc. v. United States, 334 U.S. 110, 128 (1948).

until its power is eviscerated" by the government or some other means.[48]

In the instant case, plaintiffs submit, it would undercut enforcement of the Advisers Act if an unregistered investment advisor were allowed to continue the performance of an unlawful investment advisory contract and attain the fruits thereof, because such advisor had managed to evade registration for one or three years. The conclusion of the court below to the contrary was error which, if allowed to stand, would encourage the very kind of conduct the Advisers Act was designed to prevent.

B. The Court Below Improperly Applied A Fraud Theory In Resolving Issues Governed By Contract Law.

Under well-established contract law,

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[48] 603 F.2d at 296.

there are a number of exceptions to the rule that the statute of limitations runs from the accrual of the plaintiff's right of action. One exception arises where a contract calls for continuous performance consisting of several items, and payment, although agreed to, has not been promised at any particular time. Another exception is created where there is a fiduciary relationship between the parties.[49] Both exceptions obtain in this case.

1. **The Contract In This Case Is Executory And The Date Of Final Payment Is Uncertain.**

Plaintiffs argued below that the contract in this case is executory, since

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[49] 18 Williston on Contracts, § 2026A (3d Ed. 1978). On a continuing contract, recovery of damages is allowed "at any time within the statutory period computed from the time when the completed performance was due". Id. at § 2028.

performance on both sides remains to be completed. In addition, the date of the payment agreed to is uncertain, since such payment is contingent on future events. Plaintiffs contended that the "executory" exception is highly applicable herein, since the payments which have yet to be paid (and have not even been determined) are malum prohibitum. To hold that the statute of limitations has run with respect to such payments would result in the "anomaly of the right to recover being barred before the cause of action arose."[50]

The court below however, disposed of plaintiffs' "executory" exception

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[50] McCarthy v. First National Bank of Rapid City, North Dakota, 223 U.S. 493 (1911). In McCarthy, this Court held that the statute of limitations on an usurious loan begins to run on the date of payment of the usurious interest.

argument by holding that the "[t]he contract was not executory as KKR was bound to perform under the contract". (A-24) The court's conclusion that a contract that is only partially performed is not executory is irrational, and flies in the face of long accepted contract law.[51] Thus, an executory contract has been defined as follows:

> "An executory contract is one in which a party binds himself to do or not to do a particular thing, whereas an executed contract is one in which the object of the agreement is performed and everything that was to be done is done."[52]

Clearly, the contract in this case, which has not been fully performed, is

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[51] The court apparently confused the forming of the contract which is complete as soon as promises are exchanged, with performance of the promises. Where promises remain to be performed, the contract is executory.

[52] 17 Am. Jur. 2d Contracts § 6, p. 341.

executory on both sides.

In addition to holding that the contract in this case was not executory, the court below held that an illegal advisory contract which has not been fully performed may be enforced once "the statutory period has passed". (A-24) Plaintiffs submit that the refusal of the court below to concede that the contract was executory and to acknowledge the unlawful nature of the payments which remain to be paid thereunder, resulted in a decision which frustrates the legislative purpose of § 215.

2. An Ongoing Fiduciary Relationship Exists Between The Parties.

This Court has held that "[t]he Investment Advisers Act of 1940 . . . reflects a congressional recognition 'of the delicate fiduciary nature of an

investment advisory relationship.'"[53] Thus, since defendants are fiduciaries, this case comes within the recognized contract exception.

Moreover, the fiduciary position of defendants would preclude application of the "commitment theory" utilized by the court below, even if this were a fraud action involving a sale. Thus, for example, in Buccino v. Continental Assurance Co.,[54] the court denied summary judgment where the plaintiffs alleged that the defendants had breached their fiduciary duty to an employee benefit plan (the "Fund"), by inducing it to buy and retain inappropriate insurance policies. Rejecting the "commitment

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[53] S.E.C. v. Capital Gains, 375 U.S. at 191-192 (1963).

[54] 578 F.Supp. 1518, 1521 (S.D.N.Y. 1983).

theory", the court held that the defendants "were under a continuing obligation to advise the Fund to divest itself of unlawful or imprudent investments", and their failure to do so gave rise to a wrong which was "independent" of the original purchase of insurance coverage,[55] and thus plaintiffs' action was not time-barred.

In this equitable action, the fiduciary duty of the defendants prevents them from asserting the expiration of the statute of limitations as a defense to an action based on their continuing statutory violation.

CONCLUSION

As was recently noted in connection with the Investment Adviser Oversight Act

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[55] See also, Morrissey v. Curran, 567 F.2d 546 (2d Cir. 1977).

of 1992, between 1981 to 1991, the number of investment advisers has increased from 5,100 to 17,500, and the assets under their management has soared from $450 million to $5.4 trillion, more than twice the amount deposited in U.S. commercial banks. The S.E.C. is currently able "to inspect each investment adviser once every 25 to 30 years".[56]

By further limiting the already limited right of advisory clients to safeguard their monetary interests, the court below effectively eliminated a major portion of the protection provided by the Advisers Act, thus permitting situations such as this, where an adviser may invest billions of pensioners' dollars in speculative leveraged buyouts,

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[56] Senate Report No. 102-312, 102d Cong., 2d Session (1992), p. 2.

and charge exorbitant fees, without any oversight. This should not be allowed.

For the reasons set forth above, the instant petition should be granted.

Dated: New York, New York
September 25, 1992

Respectfully submitted,

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APPENDIX

APPENDIX TO PETITION FOR CERTIORARI

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UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 1373—August Term, 1991

(Argued: May 22, 1992 Decided: June 30, 1992)

Docket No. 92-7028

PHYLLIS KAHN and STEVEN G. THORNE,

Plaintiffs-Appellants,

—against—

KOHLBERG, KRAVIS, ROBERTS & CO., a New York Limited Partnership, KKR ASSOCIATES, a New York Limited Partnership, and WHITEHALL ASSOCIATES, L.P., a Delaware Limited Partnership,

Defendants-Appellees.

Before:

PRATT and ALTIMARI, *Circuit Judges*,
and KELLEHER, *District Judge*.*

* Honorable Robert J. Kelleher, Senior United States District Judge for the Central District of California, sitting by designation.

Plaintiffs Phyllis Kahn and Steven G. Thorne appeal from the dismissal by the United States District Court for the Southern District of New York, John S. Martin, Jr., *Judge*, of their complaint pursuant to Fed. R. Civ. P. 12(b)(6) on the ground that the action was barred by the statute of limitations. Affirmed.

SIDNEY B. SILVERMAN, New York, New York, (Silverman, Harnes, Obstfeld & Harnes, of counsel), *for Plaintiffs-Appellants*.

F. J. ZEPP, New York, New York, (Latham & Watkins, of counsel), *for Defendants-Appellees*.

ROBERT J. KELLEHER, *District Judge*:

Plaintiffs Phyllis Kahn and Steven G. Thorne appeal from the dismissal by the United States District Court for the Southern District of New York, John S. Martin, Jr., *Judge*, of their complaint pursuant to Fed. R. Civ. P. 12(b)(6) on the ground that the action was barred by the statute of limitations. We affirm.

I. BACKGROUND

Plaintiffs commenced this direct and derivative action on August 21, 1991, seeking rescission of an investment advisory agreement entered into on September 25, 1987 by the Minnesota State Board of Investment (the "State

Board"), as trustee for certain state employee pension funds (the "Retirement Funds"), and the defendant Kohlberg, Kravis, Roberts & Co. ("KKR"), on the grounds that the agreement violates the Investment Advisers Act of 1940, 15 U.S.C. § 80b-1 *et seq.* (1992) (the "IAA"), in several ways.

The 1987 Agreement provided that the Board was irrevocably committed to investing $146.6 million with KKR for investments that KKR chose, and to paying KKR for its investment advisory services. At KKR's direction, the Board would invest as a limited partner in certain limited partnerships established by KKR in order to acquire target businesses. Defendant KKR Associates, which is controlled by KKR, would act as the general partner. Defendant Whitehall, Associates, L.P., was the limited partnership created to facilitate the takeover of RJR Nabisco in 1988/89.

The Complaint alleges that the agreement violates the IAA in that KKR has failed to register as an investment adviser, 15 U.S.C. § 80b-3, that pursuant to it, in relation to the RJR transaction, KKR is to receive performance-based compensation which is prohibited, 15 U.S.C. § 80b-5, and that it fails to disclose the nature of the compensation to be received by KKR, 15 U.S.C. § 80b-6.

Plaintiffs sought a declaration that the 1987 Agreement, the "Whitehall Agreements", and the "KKR-Whitehall Agreements" are void as well as a restitution of all fees paid to KKR pursuant to the agreements. These additional agreements are the partnership agreements used to facilitate the takeover.

KKR, KKR Associates, and Whitehall moved to dismiss the Complaint pursuant to Fed. R. Civ. P. Rules 12(b)(6) and 12(b)(7) on the grounds that (a) plaintiffs

lacked standing to assert their claims, (b) plaintiffs had failed to join an indispensable party, (c) plaintiffs' claims were barred by the statute of limitations, and (d) plaintiffs were guilty of laches. The district court granted defendants' motion on the ground that the claims were barred by the statute of limitations and found it unnecessary to reach the other issues.

The jurisdiction of this Court is based upon 28 U.S.C. § 1291.

II. WHAT IS THE PROPER STATUTE OF LIMITATIONS APPLICABLE TO ACTIONS FOR RESCISSION UNDER THE IAA?

A. Creation of Private Cause of Action under IAA

The Investment Advisers Act regulates the conduct of investment advisers and provides that it may be enforced by the Securities and Exchange Commission through an action for injunctive relief. Section 215 of the IAA provides that contracts whose formation or performance would violate the act are void. In *Transamerica Mortgage Advisors, Inc. (TAMA) v. Lewis*, 444 U.S. 11, 100 S. Ct. 242 (1979), the Supreme Court held that this created an implied private cause of action for rescission of the void contract and restitution, and that this was the sole private remedy available under the Advisers Act. *Id.* at 247, 249.

Since the cause of action for rescission pursuant to the IAA is implied, the court must determine the appropriate limitations period. This determination is a matter of law and thus is decided by this Court *de novo*.

B. Law Regarding Statute of Limitations for Implied Federal Causes of Action

When Congress has failed to provide a statute of limitations for a federal cause of action, courts generally borrow the state statute of limitations most analogous to the case at hand. *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, ____ U.S. ____, 111 S. Ct. 2773, 2778 (1991). Because this rule has been followed for so long, if Congress is silent it is ordinarily assumed that it intends for the court to engage in state borrowing. *Id.*

The Court has recognized " 'a closely circumscribed exception' " when it finds that "a state limitations period would frustrate the policies embraced by the federal enactment." *Id.* Federal borrowing is followed " ' 'when a rule from elsewhere in federal law clearly provides a closer analogy than available state statutes, and when the federal policies at stake and the practicalities of litigation make that rule a significantly more appropriate vehicle for interstitial lawmaking.' ' " *Id.*

> State legislatures do not devise their limitations periods with national interests in mind, and it is the duty of the federal courts to assure that the importation of state law will not frustrate or interfere with the implementation of national policies.

Del Costello v. International Bhd. of Teamsters, 462 U.S. 151, 103 S. Ct. 2281, 2289 (1983) (citation omitted).

The "delicate" determination of the appropriate limitations period is made by following a "hierarchical inquiry", most recently summarized in *Lampf*.

1. Step One—Should the Limitations Period be Uniform?

a. The first step is to determine whether the statute of limitations should be uniform:

> Where a federal cause of action tends in practice to "encompass numerous and diverse topics and subtopics," . . . such that a single state limitations period may not be consistently applied within a jurisdiction, we have concluded that the federal interests in predictability and judicial economy counsel the adoption of one source, or class of sources, for borrowing purposes.

Lampf, 111 S. Ct. at 2779.

b. Examples of Step One

Thus the Court has determined that a uniform statute of limitations should apply for all RICO cases since RICO claims could be analogized to an endless number of state actions on the basis of the great variety of possible predicate acts for RICO claims. *Agency Holding Corp. v. Malley-Duff Associates, Inc.*, 483 U.S. 143, 107 S. Ct. 2759, 2763-64 (1987). The Court also noted that many of the concepts and elements of RICO claims, such as a "RICO enterprise" and a "pattern of racketeering activity" had no analogue at common law. *Id.* at 2764.

Likewise the Court determined that claims under 42 U.S.C. § 1983 should have a uniform statute of limitations since "every § 1983 claim can be favorably analogized to more than one of the ancient common-law forms of action . . . [or to] one arising under a statute," each of which could have a different statute of limitations. *Wilson v. Garcia*, 471 U.S. 261, 273-75, 105 S. Ct. 1938, 1945-47

(1985). Not only would this create uncertainty for all parties, but scarce resources would be dissipated on "unproductive and ever-increasing litigation." *Id.* at 275.[1]

2. Step Two—Should the Limitations Period be Derived from a Federal or State Source?

The second step, assuming that the court decides to apply a uniform period, is to determine whether this period should be derived from a state or federal source. *Lampf*, 111 S. Ct. at 2779. In making this determination, "the court should accord particular weight to the geographic character of the claim." *Id.* If the federal action has links to more than one state it poses the " ' 'danger of forum shopping and at the very least . . . guarante[es] . . . complex and expensive litigation over what should be a straightforward matter.' ' " *Id.* Additionally, borrowing from state sources poses the risk of "the application of [an] unduly short state statute of limitations that would thwart the legislative purpose of creating an effective remedy." *Agency Holding*, 483 U.S. at 154 (citations omitted).

3. Step Three—Does a Federal Source Provide a Closer Fit?

a. If the court finds that the interstate character of the action supports federal borrowing, the "presumption of state borrowing requires that [it] determine that an analogous federal source truly affords a 'closer fit' with the cause of action at issue than does any available state-law source." *Lampf*, 111 S. Ct. at 2779. The relevant considerations will include, but not be limited to, "commonality of purpose and similarity of elements," *id.*, which period

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1 In *Wilson* the Court chose to apply a uniform state statute. 471 U.S. at 275-6.

will further the policies behind the federal law, practicalities of application, the interest in uniformity, and the interest in having clearly defined, easily applied rules.

b. Examples of Steps Two and Three

Thus, in *Occidental Life Ins. Co. v. EEOC*, 432 U.S. 355, 97 S. Ct. 2447 (1977), the Court decided that enforcement suits brought by the EEOC under Title VII of the 1964 Civil Rights Act should not be subject to a state limitations period since those limitations might unduly hinder the policy behind the Act by placing too great an administrative burden on the agency. 432 U.S. at 367-372; *see also Del Costello*, 462 U.S. at 172.

Similarly in *Del Costello*, 462 U.S. at 165-66, the Court determined that the state limitations period for vacation of an arbitration award in a commercial setting was too short to apply to an employee's hybrid breach of a collective bargaining agreement/duty of fair representation claim since the aggrieved employee needed more time to determine that he had a claim, retain counsel, investigate the issues not raised by the union, and frame his suit. *Id.* Moreover, it might be difficult to determine precisely when the claim accrues which would be crucial if the limitations period was extremely short. *Id.* at 165 n.16.

In contrast, the brief state period for vacating an arbitration award was appropriate to the usual commercial arbitration since the parties will usually be represented to counsel, or have some experience and sophistication, and the action to vacate will usually involve issues that were already presented and contested in the arbitration proceedings. *Id.* at 166. The Court also pointed out the substantive difference between the two claims. *Id.* at 167.

The *Del Costello* Court also rejected the lengthy state limitations period for a breach of contract action since it would frustrate the federal policy of resolving labor disputes quickly. *Id.* at 168-9.

Finally, the *Del Costello* Court decided that the appropriate source for borrowing was a federal statute that was fashioned to accommodate the same competing national interests and to suit the same unique context of labor relations. *See id.* at 171-2.

In *Agency Holding*, 483 U.S. at 153, the Supreme Court first determined that RICO claims have a multistate nature since they often involve an interstate transaction, and indeed must have some nexus to interstate or foreign commerce, and the predicate acts could take place in several states. *Id.* The Court contrasted this to § 1983 claims that require no interstate nexus and tend to take place in one state. *Id.* at 155.

The Court in *Agency Holding* then concluded that the federal antitrust statutes provided a closer analogy to a RICO claim than any state law alternative. *Id.* at 155. The Court considered the similarities in purpose and structure between the two federal statutes[2], the Congressional intent to pattern the RICO statute after the antitrust statute, the uniqueness of the concepts involved in a RICO claim, the federal policies at stake and the multistate nature of the claims. *Id.* at 150-155.

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2 "Both RICO and the Clayton Act are designed to remedy economic injury by providing for the recovery of treble damages, costs, and attorney's fees. Both statutes bring to bear the pressure of 'private attorneys general' on a serious national problem for which public prosecutorial resources are deemed inadequate; the mechanism chosen to reach the objective in both the Clayton Act and RICO is the carrot of treble damages. Moreover, both statutes aim to compensate the same type of injury; each requires that a plaintiff show injury 'in his business or property by reason of' a violation." *Agency Holding*, 483 U.S. at 151.

4. Special Procedure if Statute Also has an Express Cause of Action with an Express Statute of Limitations

Lampf also provides a special procedure in the case of a cause of action that is implied from a statute that also includes an express cause of action with an express time limitation. *See* ____ U.S. at ____, 111 S. Ct. at 2780.

First, if the statute of origin has an express remedial provision that is analogous, then the limitation period applicable to that should be used. *Id.* The rationale for this is clear:

> We can imagine no clearer indication of how Congress would have balanced the policy considerations implicit in any limitations provision than the balance struck by the same Congress in limiting similar and related protections.

Id.

Thus, the *Lampf* Court determined that the one and three year limitations periods applicable to many of the express causes of action under the 1933 and 1934 Securities Acts were the appropriate source for a limitations period for the implied cause of action under § 10(b) of the 1934 Act. The Court refused to apply the five year statute of limitations applicable to the § 20A insider trading cause of action which was created over 50 years later on the grounds that the provision focused upon a "specific problem" and was longer on account of the "unique difficulties in identifying evidence of such activities" and the purpose of § 20A " 'to provide greater deterrence, detection and punishment of violations of insider trading.' " *Id.* at 2781 (citations omitted). The Court found that not only was there no indication that the drafters of § 20A intended

to extend that enhanced protection to other provisions of the 1934 Act, but that the text expressed their intent to leave other laws unaffected. *Id.*[3]

5. Application to IAA Action for Rescission

a. Step One—Should the Limitations Period be Uniform?

Following the analysis set out above, the first step is to determine whether the limitations period should be uniform. This turns upon whether the "federal cause of action tends in practice to 'encompass numerous and diverse topics and subtopics,' such that a single state limitations period may not be consistently applied within a jurisdiction." *Lampf*, ____ U.S. at ____, 111 S. Ct. at 2779.

The plaintiffs argue that a uniform statute of limitations is not required since no catalogue of claims encompassing numerous and diverse topics is possible under the IAA as the only available cause of action is one for rescission of the adviser's contract. Defendants argue that a claim for rescission pursuant to § 215 could be analogized to a number of different state causes of action. A § 215 claim may be premised upon a violation of any provision of the IAA. If a court focused upon the alleged violation underlying the claim, it could conclude that the claim should be analogized to a violation of state securities regulations or the state professional code, common law breach of contract, fraud, or an action for rescission.

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3 While the court may be influenced by evidence of Congressional intent, there is no *need* to show that at the time that Congress provided the express federal limitations period it intended that it would apply to this cause of action. *Del Costello*, 462 U.S. at 169 n. 21. Rather, a source should be chosen "because it is the most suitable source for borrowing." *Id.*

Plaintiffs' analysis focuses upon the single remedy available and ignores the fact that there are numerous and varied grounds for invoking it. Clearly the inquiry into the different bases for a claim should focus on the factual and legal theories supporting the claim. Given the numerous possible arguments that could be made for analogizing § 215 claims to different causes of action, and the resulting potential for uncertainty and an excess of useless litigation, this appears to be an ideal case for a uniform period.[4] Having determined that the limitations period should be uniform, the next step is to determine whether the court should turn to a federal or state source.

b. Step Two—Should the Limitations Period be Derived from a Federal or State Source?

The second step, assuming that the court decides to apply a uniform period, is to determine whether this period should be derived from a state or federal source. As stated above, the court should consider whether the claim has a multistate character and the federal interest in having uniform and clearly defined rules, whether state limitations periods might thwart the federal legislative purpose, similarity of elements, and practicalities of application.

The plaintiffs contend that there is no basis for departing from the general state borrowing rule. They contend that the rescission claim could never be multistate in nature since the only parties who could bring the claim are the parties to the contract. Unlike the RICO and duty of fair representation claims presented in prior cases, the

4 In fact, notwithstanding plaintiffs contention that a uniform period is improper, they are actually requesting that a uniform period be applied. They just want that period to be the state period for rescission of an unlawful contract.

rescission claim has a clear counterpart at common law, *i.e.*, the action for rescission of an unlawful contract. They contend that the intent of the IAA was to impose an obligation upon investment advisers similar to the fiduciary duty already imposed by state law.

Defendants argue that the claim is multistate in nature. First, the claim must involve the means of interstate commerce for jurisdictional purposes. 15 U.S.C. § 80b-14. Second, the violations may occur in several states. Third, it may involve multistate plaintiffs and defendants. They contend that the § 215 claim is more like a RICO claim, found to be multistate in *Agency Holding*, than a § 1983 claim, found to be confined to a single state in *Wilson v. Garcia*.

Again, defendants' arguments are far more persuasive. The violations could occur in numerous states both with respect to a single plaintiff and with respect to multiple plaintiffs. It is certainly preferable to have one uniform period and to eliminate the uncertainty and excessive litigation that could ensue if the various state's limitations period could potentially apply.

c. Step Three—Does a Federal Source Provide a Closer Fit?

The elements of a § 215 claim are more similar to claims under the Securities Acts than claims for breach of the common law fiduciary duty. Contrary to plaintiffs' characterization, the intricate regulations in the Act are not simply restatements of the common law fiduciary duty concept. They are detailed and complex provisions that demand the same kind of attention as those found in the 1933 and 1934 Securities Acts.

Most importantly, the limitations period provided for in the securities area represents a balancing of the same interests as are involved in the IAA. Both regulate the honesty and integrity of those who deal commercially on the national securities markets. In fact, plaintiffs commence their Complaint by stating that the securities statutes and the IAA were designed as part of a single body of National Securities Laws for the purpose of protecting investors and the securities markets from abuses.

The federal securities statutes clearly provide a "closer fit" than any available state period.

d. Did the Court Below Choose the Wrong Federal Law Source?

Plaintiffs' final contention is that even if federal borrowing is to be preferred in this case, that the court below borrowed from the wrong source.

The district court held that the most analogous federal limitations period was either the one year period found in § 36(b) of the Investment Company Act, 15 U.S.C. § 80a-1, *et seq*. (the "Company Act"), or the one year from discovery/three years from the violation period applied under both the 1933 and 1934 Securities Acts for sale of unregistered securities, §§ 77*l* and 77m, fraud in connection with a registration statement § 78r, fraud in connection with the offering or selling of securities, § 78i(e), § 78cc(b), and Rule 10b-5.

i) Section 36(b) of the Company Act

The plaintiffs contend that § 36(b) of the Company Act is not analogous since it is a "unique" provision whose limitation period is directly related to its "extraordinary character."

The Company Act was enacted at the same time as the IAA and regulates the conduct of investment companies. Both acts impose similar requirements on investment advisers and investment companies and proscribe similar conduct. Section 215 of the IAA was part of the original enactment in 1940, while § 36(b) of the Company Act was added in 1970.

Section 36(a) regulates the relationship between an investment company and a person who serves as an officer, director, adviser, or underwriter to that company. Section 36(b) regulates the relationship between an investment company and any person acting as an investment adviser to that company. An action pursuant to § 36(a) must be brought within five years of the violation. There is no express time limit on bringing an action under § 36(b), but the plaintiff may collect only those damages that have accrued in the prior year. Section 36(b) may be enforced only by the SEC and security holders of the company.

Plaintiffs contend that Congress could not have intended to apply the one year period of the 1970 amendment when it enacted § 215 in 1940. Yet, as pointed out in *Del Costello*, the Court need not determine that Congress had the specific intent to apply the borrowed period.[5]

Plaintiffs also contend that § 36(b) is not analogous to § 215 since § 36(b) "create[d] an entirely new right" and that unlike the § 215 right, it may not be enforced by the

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5 The plaintiffs cite *Lampf* for the proposition that the court must demonstrate some basis that Congress, when it passed the later legislation, intended for its limitation period to apply to the pre-existing legislation. As explained *supra* that is not the law. Furthermore, it seems that the *Lampf* Court addressed the issue primarily because there was express language in the later legislation disclaiming any intent to effect other laws. *See* ___ U.S. at ___, 111 S.Ct. at 2780.

investment company "client." *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 535-541, 104 S. Ct. 831 (1984).

They contend that the limitations period was made so short as part of a tradeoff with the securities industry for the new stricter standards it imposed. The statute imposes stricter standards upon the acceptable amount of compensation an investment adviser may collect. The limitation period is directly tied to this aspect of the legislation since rather than barring the assertion of a claim, it limits the period during which damages can accrue to one year prior to the filing of the action. *See* § 36(b)(3). Furthermore, the one year period is fully adequate for the § 36(b) claim since other provisions of the statute require that the shareholders review and approve the subject contracts annually. *See* 15 U.S.C. § 80a-15(c).

Plaintiffs contend that § 36(a) of the Company Act provides a more appropriate source since it was enacted at the same time as § 215 and at the time it was the only other federal statute to regulate a comparable fiduciary relationship at that time.

Defendants contend that § 36(b) is more analogous to § 215 since it regulates the relationship between an adviser and client. Further, the one year period represents the appropriate balance of interests by protecting investors and minimizing the disruption to the investment advisory industry.

Moreover, the short period is more appropriate in this case since defendants cannot conceal their violations as they are all premised on the failure to register. *See* 15 U.S.C. § 77m.

Again, defendants arguments are more persuasive. There seems to be no basis for applying the excessively

long five year period of § 36(a). Moreover, § 36(b) focuses on the analogous relationship, involves the same policy concerns, and provides for a similar restitutionary remedy.

2) The 1933 and 1934 Securities Acts

The one/three year period applicable to various provisions of the 1933 and 1934 Acts provides that suit must be commenced within one year of the discovery of the claim and at least three years after the date of the injury.

Plaintiffs contend that this one/three year period is not appropriate since those provisions are entirely different from the § 215 claim. Unlike § 215, the Securities Act sections apply to the sale of securities, involve claims of misrepresentation or fraud in relation to those sales, and require that there be some actual fraudulent intent. They characterize § 215 as focusing upon the investment adviser's fiduciary duty and imposing a far stricter standard.

Finally they argue that § 29 of the 1934 Act demonstrates Congress's intention that the one/three year period apply only to causes of action for fraud. 15 U.S.C. § 78cc(b). When originally enacted § 29 contained no limitations period. It was subsequently amended to provide that a one/three year period would apply but only to claims based upon § 15, which is an antifraud provision. Since § 29 can also encompass non-fraud claims, the inference is that the one/three year period should not apply to those claims. Defendants contend that the IAA claims are also similar to the 1933 and 1934 Act claims. The purposes behind the statutes are almost identical. In fact, the Supreme Court has said that "Congress intended the [IAA] to be construed like other securities legislation

'enacted for the purpose of avoiding frauds.' " *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195, 84 S. Ct. 275, 284-5 (1963) (citations omitted). Both sets of regulations operate in the same securities market context, proscribe similar conduct, and impose registration and disclosure requirements.

Specifically, they contend that the § 203 claim is identical to the 15 U.S.C. §§ 77(*l*) and 77m, failure to register claims; that § 206 claim duplicates the Rule 10b-5 fraud claim, and that the § 215 rescission remedy is parallel to the § 29(b) rescission remedy.

Again, defendants are correct. The one/three year period used in the Securities Acts is the most appropriate since it reflects the accepted balancing of the same interests and is consistently applied to claims posing the similar factual and legal issues.

Therefore, this Court finds that the appropriate limitations period to apply to an IAA action for rescission is either one year from the wrong or one year from the discovery/three years from the wrong.

III. WHEN DID STATUTE OF LIMITATIONS BEGIN TO RUN IN THIS CASE?

A. In Applying Statute of Limitations Should Court Utilize Continuing Wrong Theory?

Plaintiffs argue that in applying the statute of limitations the lower court should have utilized the continuing wrong theory and found that defendants' conduct was a continuing wrong and that the statute of limitations therefore has not yet begun to run.

The district court refused to apply the continuing wrong theory holding that it "has been consistently rejected."

The plaintiffs argue that the continuing wrong theory has been consistently applied in federal actions excluding one exception which does not apply here.[6]

Federal courts do recognize a continuing wrong theory, yet it does not apply in this case. The doctrine applies when the defendant's conduct causes plaintiff to sustain damages after the time when the statute of limitations would have expired if it commenced at the time of defendant's first act. Instead, the claim accrues each time the plaintiff sustains damages. The rule is based primarily upon the impracticality and unfairness of requiring a plaintiff to institute his action before he can predict his damages. *See Taylor v. Meirick*, 712 F.2d 1112, 1119 (7th Cir. 1983).

For example, in the antitrust context, the courts hold that " 'each time that a plaintiff is injured by an act of the defendants a cause of action accrues to him to recover the damages caused by that act.' " *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 295 (2d Cir. 1979), *cert. denied*, 444 U.S. 1093 (1980) (*quoting Zenith Radio Corp. v. Hazeltine Research, Inc.*, 401 U.S. 321, 338, 91 S. Ct. 795, 806 (1971)). The *Berkey* court explained that the statute begins to run at the time that the plaintiff sustains injury and not when the defendant acts, since anticompetitive conduct by the defendant may give rise to damages in the future which are not predictable at the time of the initial act or within the limitations period. *Id.* at 295-6 (*citing Zenith Radio*, 401 U.S. at 339-40).

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6 The plaintiff cites to cases wherein the continuing wrong theory was applied to federal actions for antitrust, patent infringement, and violation of civil rights. They claim that the cases relied upon the district court involve the exception for completed sales transactions. They claim that since this action is based upon an on-going service contract, which is executory, the completed sales doctrine does not apply.

In civil rights cases based upon a denial of seniority rights, the courts have held that "the denial of seniority rights was a continuing discrimination." *Allen v. Amalgamated Transit Union*, 554 F.2d 876, 880 (8th Cir. 1977) (collecting cases). It is clear that this is based upon the fact that the plaintiff is continuing to receive disparate treatment, in violation of the civil rights statute, as long as he remains employed and is not given seniority rights. *See id.* at 880-881 n.5.

Similarly in a civil rights class action based upon installment contracts offered on different terms on the basis of race, the court said that, as in the antitrust context, "the relationship [between the sellers and purchasers] constituted a prolonged and continuing invasion of the rights of the purchasers." *Baker v. F & F Invest.*, 420 F.2d 1191, 1200 (7th Cir. 1970), *cert. denied*, 400 U.S. 821 (1970). The court said that the limitations period did not begin to run at the execution of each contract since the defendants repeated the overt acts of entering into discriminatory contracts and reaping the unlawful benefits. *Id.* The court focused on the fact that plaintiffs had alleged a conspiracy to establish an ongoing discriminatory relationship with the entire class of plaintiffs and analogized the situation to the antitrust cases.

In the copyright infringement context the court found that the infringement was a continuing wrong as long as the defendant and his co-tortfeasors continued to sell the infringing copies. *Taylor*, 712 F.2d at 1119. Thus, plaintiff had to bring the suit within the statutory period from the last infringing sale, but he could reach back to sales before the statutory period in order to collect his damages. *Id.*[7]

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7 There appears to be some conflict about whether the continuing wrong theory allows a plaintiff to reach back past the limitations period

Defendants contend that the completed sales transaction theory or commitment theory applies here. That theory provides that the wrong occurs when the plaintiff makes a completed sales transaction. *See, e.g., Department of Economic Dev. v. Arthur Andersen & Co.*, 683 F. Supp. 1463, 1475 (S.D.N.Y. 1988); *Ingenito v. Bermec Corporation*, 376 F. Supp. 1154, 1184 (S.D.N.Y. 1974). In other words once plaintiff has committed itself to the transaction, the claim accrues and thus the statute begins to run. When the plaintiff actually fulfills his obligations under that contract, that does not constitute a new wrong since he was already bound to do so. *Id.* Thus, subsequent payments on a completed sales transactions affect the amount of damages but do not constitute separate wrongs.

The test for whether the commitment theory applies to a contract calling for subsequent payments is whether the plaintiff was committed to pay that amount under the contract or whether he retained the right to terminate the contract and not pay that amount. *Arthur Andersen*, 683 F. Supp. at 1475; *Ingenito*, 376 F. Supp. at 1184.

For example, in *Ingenito*, 376 F. Supp. at 1184, the court found that payments on a promissory note given as consideration for a completed sale did not give rise to new claims, while payments pursuant to a maintenance contract did since by its terms plaintiff was not obligated to continue the maintenance contract and retained the right to cancel it at any time. *Id.*

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to point to wrongful conduct, but not to calculate damages, or whether it permits the plaintiff to reach back in order to calculate his damages as well. *Compare Taylor*, 712 F.2d at 1119 ("letting him reach back and get damages for the entire duration of the alleged violation") *with Berkey Photo*, 603 F.2d at 295 ("The plaintiff, therefore, clearly can recover only for overcharges suffered since the beginning of the limitations period. It remains to be decided, however, whether the conduct element of the offense may be satisfied by wrongful action occurring before the limitations period.")

Defendants contend that here the 1987 Agreement created a binding obligation upon the Board to commit a certain amount of capital to investments chosen by KKR. The subsequent payment of fees or rendering of advice by KKR could not give rise to a new cause of action. Since the plaintiffs allege that the contract violated the IAA at the moment it was entered into, the claim accrued at that time.

Plaintiffs argue that the 1987 Agreement was not binding since it could be cancelled by rescission. It is settled though that the commitment theory tests whether a contract is binding or terminable *by its terms*. *Freschi v. Grand Coal Venture*, 551 F. Supp. 1220, 1229-30 (S.D.N.Y. 1982). The possibility of rescinding the contract on the grounds that it violated the IAA does not make the subsequent payments new wrongs.

Plaintiffs assert a number of theories for why the continuing wrong theory should apply in this case. They are all basically the same theory, rephrased, and all are meritless.

Plaintiffs argue that the continuing wrong theory applies since the agreement calls for defendants to render on-going investment advice. They contend that this continuing "special relationship" constitutes a continuing wrong relying upon *Baker*, discussed above, and *Eli Lilly and Co. v. EPA*, 615 F. Supp. 811 (S.D. Ind. 1985).

The *Baker* principle does not apply in this case since the defendants entered into one discrete contract with plaintiffs after which plaintiffs were committed to invest a set amount of money. The *Eli Lilly* reasoning is also not applicable since that case focused on the ongoing statutory authority of the EPA over pesticide registrants under the Federal Insecticide, Fungicide, and Rodenticide Act.

Eli Lilly, 615 F. Supp. at 822-823. The relationship between two private parties pursuant to a contract cannot be equated with that kind of relationship, even if it is regulated by statute.

Similarly, plaintiffs contend that the continuing wrong theory applies since the violation of the IAA is ongoing. They assert that a violation of § 203 occurs whenever an unregistered person functions as an investment adviser. Thus, each time KKR acted as an investment adviser, that constituted a new violation. They contend that the fact that KKR was already committed to do those acts does not alter the fact that those acts are independent violations of the statute.

This argument ignores the clear holding of the courts that performance under the contract merely affects damages and does not give rise to a new cause of action.

Plaintiffs contend that the continuing duty of KKR to register extends the limitations period. Yet, the cases they rely upon do not support this argument. One case actually applies the commitment theory to a fiduciary's duty to withdraw from an imprudent investment that it is not obligated to continue. *Buccino v. Continental Assur. Co.*, 578 F. Supp. 1518, 1521 (S.D.N.Y. 1983). The second case holds that the offense of a draftee's failure to advise the draft board of his current address was not committed and completed on the first day of such failure, but rather was a continuing offense as long as the draftee fails to update the board. *United States v. Guertler*, 147 F.2d 796, 797 (2d Cir. 1945). The draftee owes a duty to the government to register, and every day on which he fails to fulfill this duty he is harming the government.

The investment adviser also owes a duty to the government to register. Yet, he harms the purchaser of his

investment advice at the time that he enters into a contract that commits the purchaser to pay for the advice. Moreover, the different context of *Guertler* and the fact that the commitment theory has been consistently applied in the securities law context, (*see Arthur Andersen*, *Ingenito*, *Freschi*) suggest that it is far more appropriate to apply the commitment theory here.

Similarly, plaintiffs argue that the agreement is executory and that the statute of limitations on an executory contract does not begin to run until the contract becomes non-executory. Plaintiffs are not correct. The contract was not executory as KKR was bound to perform under the terms of the contract, the Board was bound to perform once KKR had performed, and the Board could have sued KKR for breach if it failed to perform.

Plaintiffs' final plea is that since the payments called for under the contract are illegal, to the extent that they are not yet due, the Court will be sanctioning the payment of illegal fees if the action is barred. They claim that at least they should be able to rescind the remainder of the agreement or obtain a declaration that the contract is illegal so that the Board can withhold further performance.

This argument ignores the whole purpose behind a statute of limitations and the importance of the policy of repose. The function of a statute of limitations is to set a time after which conduct will not be subject to challenge, on any grounds. After the statutory period has passed, the plaintiffs may not bring the action regardless of the relief requested.

Therefore, on the claim for rescission of the 1987 Agreement, the court properly found that the wrong occurred in 1987. Applying the more liberal one/three year statute of limitations to that date, the district court

did not err in finding that the statute has expired since over three years had passed before this action was filed on August 20, 1991.

B. Should the Court Determine that Contract at Issue for the Purpose of Commencing the Statute of Limitations was the 1987 Contract or the 1988/89 Partnership Agreements?

Plaintiffs argue that the lower court incorrectly determined that the date of the contract at issue was 1987. They contend that it ignored the four allegedly illegal contracts entered into in 1989. They argue this finding of fact should be overturned since it was clearly erroneous.

The only contract clearly identified in the Complaint as an investment advisory contract entered into on a specified date and alleged in violation of the IAA was the 1987 Agreement. While the Complaint references the partnership agreements, it does not allege the dates on which they were entered into or how they violated the IAA. Thus, on this 12(b)(6) motion it was entirely proper for the district court to consider the 1987 Agreement as the sole basis for the accrual of the claim.

Besides, even if accrual is based upon the 1988-89 limited partnership agreements, the statute has still run. First, the cause of action would accrue when the agreements were entered into under the reasoning above.

Applying the most liberal statutory period applicable, the one year from discovery/three years from violation, found in the 1933 and 1934 Acts, the district court would be compelled to find that the period has run as over one year had passed since plaintiffs' discovery of their injury.

Discovery takes place when the plaintiff obtains actual knowledge of the facts giving rise to the action or notice of the facts which in the exercise of reasonable diligence would have led to actual knowledge. *Ingenito*, 441 F. Supp. at 554.

Both the Board and the plaintiffs knew or should have known the basis for the claims at least at the time that the 1988-89 agreements were executed. The violations of the IAA are all premised upon KKR's duty to register. The facts triggering that duty and allegedly disqualifying KKR from the exception were obviously known to the Board, as well as the investing public in general. The fact that KKR had not registered was a matter of public record. Additionally, the nature and structure of the fee arrangement was disclosed to the Board in the contract and also was widely publicized.

Plaintiffs' complaint admits that KKR was notorious for doing deals like the one with the Board and RJR. KKR publicized its services broadly, particularly at national meetings of state investment managers. The fact that it had over fifteen clients or investing partnerships (which would have triggered the duty to register and disqualified KKR for the exception) was thus clearly known to the Board and the investing public as well. KKR's intention not to register under the IAA was made public by a No-Action letter to the SEC reported in an official reporter in 1985 and by the fact that such public registration was absent from the public records.

Therefore, the district court did not err in finding that the facts giving rise to a claim to rescind the 1988/89 partnership agreements were known or should have been known at least to the Board, the party in interest, as of the time that the agreements were executed. Since one year

had passed before the instant complaint was filed, any claim to rescinding those contracts would also be barred by the statute of limitations.

We have considered plaintiffs' other contentions and find them meritless.

CONCLUSION

For the foregoing reasons, the decision of the district court is AFFIRMED.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
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PHYLLIS KAHN and
STEVEN G. THORNE,

Plaintiffs,

-against-

91CIV.5670
(JSM)

KOHLBERG, KRAVIS, ROBERTS & CO., and KKR ASSOCIATES, each a New York Limited Partnership, and WHITEHALL ASSOCIATES, L.P., a Delaware Limited Partnership,

Defendants.

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OPINION AND ORDER

JOHN S. MARTIN, JR., District Judge:

Defendants Kohlberg Kravis Roberts & Co. et al. move pursuant to FRCP 12(b)(6) and 12(b)(7) to dismiss the Complaint in its entirety. Defendants assert the following grounds for dismissal: (1) the applicable statute of limitations has expired; (2) plaintiffs lack standing to

bring an action under the Investment Advisers Act ("IAA"), either individually or derivatively on behalf of the Board or Whitehall; (3) plaintiffs have failed to name an essential party, the Board; (4) plaintiffs' claims for relief other than rescission are not cognizable under the IAA; and (5) the plaintiffs are guilty of laches. In the alternative, KKR move pursuant to FRCP 12(e) for a more definite statement of any remaining claims.

FACTUAL BACKGROUND

Kohlberg Kravis Roberts & Co., L.P., a Delaware limited partnership, and its affiliate KKR Associates, a New York limited partnership (hereinafter jointly referred to as "KKR"), organize funds for the acquisition of companies. KKR acquires these funds by soliciting

entities to commit capital to be pooled for the acquisition of companies.

Once KKR organizes a fund, KKR selects companies for acquisition, negotiating the terms of the acquisition, the terms of equity and debt financing for the acquisition, and typically obtains a controlling interest in the selected company. KKR then monitors the acquired company and often appoints designees to the Board of Directors of the acquired company. KKR bills itself as a merchant banker specializing in leverage buyouts.[1]

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[1] There is dispute as to whether KKR is a merchant banker and thus somehow exempt from the filing and disclosure requirements of the IAA or instead is an investment advisor and thus subject to the Act. As part of the Complaint, plaintiffs seek to rescind the contract between the Board and KKR on the ground that KKR is not registered under IAA and hence its contracts are voidable. For purposes of this motion to dismiss, KKR

In October of 1987, the Minnesota State Investment Board (the "Board") committed to provide $146,000,000 of Minnesota State Pension fund moneys to the 1987 Fund. The Board was one of 78 participants who entered into commitment letter agreements with KKR.

In 1988, KKR formed Whitehall Associates, L.P. ("Whitehall") for the purpose of consummating the leveraged buyout of RJR Nabisco. Pursuant to commitment agreements, the participants in the 1987 Fund, including the Board, became limited partners of Whitehall. The acquisition of RJR Nabisco was consummated in April of 1989 and Whitehall now holds a majority of the equity of RJR Nabisco.

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accepts as true allegations that it is an adviser.

Plaintiffs in this case are Phyllis Kahn ("Kahn") and Steven Thorne ("Thorne"). Kahn is an elected member of the House of Representatives of the State of Minnesota and is Chair of the State Government Division of the Appropriations Committee of the House which has oversight authority over the Board.

Thorne, as an employee of the State of Minnesota from 1973 until January 1991, contributed moneys to the Unclassified State Employees Retirement Fund, which may or may not have been committed by the Board to the 1987 Fund.[2]

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[2] It is not clear that the pension to which Thorne contributed was actually part of the assets invested by the Board in the 1987 Fund. See 1990 Minnesota Annual Report, Appendix to Reply Memorandum. However, for the limited purposes of this motion to dismiss, KKR accepts as true that Thorne is a contributor, via his pension plan, to the 1987 Fund.

Both Kahn and Thorne brought an action directly, derivatively on behalf of the Board, and derivatively on behalf of Whitehall to compel the surrender any excessive and illegal fees paid to KKR.[3]

In its amended complaint, the plaintiffs Kahn and Thorne have named the Board as a nominal defendant.

KKR now seeks to dismiss the complaint for failure to state a claim for which relief can be granted. In the alternative, KKR moves for a more

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[3]Specifically, in their complaint the plaintiffs allege that:

(a) In violation of IAA § 203, KKR has acted as an investment adviser without registering as such with the SEC.

(b) In violation of IAA § 205, KKR entered into investment advisory contracts with the Board and Whitehall which provide for excessive compensation to KKR.

(c) In violation of IAA § 206, KKR has failed to make full disclosure of its compensation under the commitment agreements.

definite statement.

DISCUSSION

The defendants first move for a dismissal on the ground that this action is untimely. Because § 215 of the IAA is silent as to the appropriate limitations period, we must determine whether to borrow from the local statute of limitations, in this case New York's period of six years, or borrow from a more analogous federal limitations period.

In general, when Congress has failed to provide a statute of limitations for a federal cause of action, a court "borrows" the local time limitation most analogous to the case at hand. Wilson v. Garcia, 471 US. 261, 266-267, 105 S.Ct. 1938, 1941-1942, 85 L.Ed. 254 (1985).

However, in recent years, an

important exception has been carved out of this rule. The Supreme Court has recognized that when the operation of a state limitations period would frustrate the policies embraced by the federal statute, borrowing from an analogous federal limitations period may be more appropriate. See, e.g., DelCostello v. International Brotherhood of Teamsters, 462 U.S. 151, 103 S.Ct. 2281, 76 L.Ed.2d 476 (1983); Agency Holding Corp. v. Malley-Duff & Associates, Inc., 483 U.S. 143, 147, 107 S.Ct. 2759, 2762, 97 L.Ed.2d 121 (1987). The rationale for such federal borrowing was stated in DelCostello:

> "[A]s the courts have often discovered, there is not always an obvious state-law choice for application to a given federal cause of action; yet resort to state law remains the norm for borrowing of limitations periods. Nevertheless, when a

> rule from elsewhere in federal law clearly provides a closer analogy than available state statutes, and when the federal policies at stake and the practicalities of litigation make that rule a significantly more appropriate vehicle for interstitial lawmaking, we have not hesitated to turn away from state law." DelCostello, 462 U.S. at 171-172, 103 S. Ct., at 2294.

In Lampf, Pleva, Lipkin, et al. v. Gilbertson, 111 S.Ct. 2773, 2278, 115 L.Ed. 2d 321, 326 (1991), the Supreme Court articulated "a hierarchical inquiry for ascertaining the appropriate limitations period for a federal cause of action where Congress has not set the time within which such an action must be brought."

First, the court must determine whether the federal interests in predictability and judicial economy counsel the adoption of a uniform statute

of limitations.

Second, assuming the court has concluded that a uniform limitations period would be appropriate, the court must determine which federal source provides the closest fit with the cause of action at issue.

With that mandate in mind, this Court turns to the case at hand.

Here the interests of predictability and judicial economy clearly support the adoption of a uniform statute of limitations. The Investment Advisers Act was, in combination with the Investment Company Act, the last in a series of enactments to protect the investing public against securities laws violations. Consistent with this Congressional scheme, the statute of limitations applicable to private causes

of action for violations of the federal securities laws found in those enactments would seem to provide a closer fit for a private cause of action under the IAA than any state law limitation period.

In this case, the most closely analogous federal limitations period is either the one year period found in § 36(b) of the Investment Company Act ("ICA") or the one year from discovery and three years after the violation limitations period which predominates in both the 1933 and the 1934 Acts. See, e.g., § 13 of the 1933 Act, 15 U.S.C. § 77m (1981); § 9(e) of the 1934 Act, 15 U.S.C. § 78i(e) (1981); § 18(c) of the 1934 Act, 15 U.S.C. § 78r(c) (1981); and § 29(b) of the 1935 Act, 15 U.S.C. § 78cc(b) (1991).

The conclusion that the 1933 and

1934 Acts provide the closest fit for determining the limitations period for private causes of action under § 215 of the IAA has been reached by at least one court. In Derby v. Perschke, No. 88-3855 (E.D. Ill. Nov. 8, 1990)(LEXIS, Genfed library, Dist. file), the court determined that the statute of limitations applicable to private claims under the IAA was the federal one and three year period found in the 1933 Act.

There is no need to resolve the issue, however, since under either limitations period this action is time-barred. We reject plaintiffs' argument that we should ignore the 1970 amendments to § 36 of the ICA and apply the five year limitations period that existed prior to that amendment.

Plaintiffs are suing to set aside

agreements entered into in the Fall of 1987. This action was filed in August 1991, four years later, and therefore should be dismissed.

Plaintiffs attempt to revive their claim by asserting a "continuing breach" theory. More specifically, Plaintiffs maintain that because the 1987 contract between KKR and the Pension remains in force, the contract is still being breached and therefore their claim is not time-barred. Because the Court has decided to look to analogous federal law rather than state law to determine the appropriate limitations period for this action, we need not address the issue of whether Minnesota applies a "continuing wrong" theory to contracts. Under the federal limitations period, this continuing wrong theory has been

consistently rejected. E.g., Korn v. Merrill, 403 F.Supp. 377 (S.D.N.Y. 1975), aff'd mem., 538 F.2d 310 (2d Cir. 1976)(in action brought under IAA against investment advisors, fact that advisor continued to receive fees after initial wrongful act did not save action from being time-barred). See Holloway v. Combined Equities, Inc., 628 F.Supp. 59 (M.D. La. 1986)(action brought under '33 Act runs from date of contract rather than date of last payment); Ingenito v. Bermec Corp., 376 F.Supp. 1154, 1184 (S.D.N.Y. 1974)(same).

Because this action is time barred, the Court need not reach the other issues.

SO ORDERED.

Dated: November 18, 1991

/s/ John S. Martin, Jr.
JOHN S. MARTIN, JR. U.S.D.J.

UNITED STATES COURT OF APPEALS
FOR THE
SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the 30th day of June, one thousand nine hundred and ninety-two.

PRESENT: HON. GEORGE C. PRATT
HON. FRANK X. ALTIMARI
Circuit Judge.
HON. ROBERT J. KELLEHER
District Judge.[4]

PHYLLIS KAHN and STEVEN G. THORNE,

Plaintiffs-Appellants,

-v.-

KOHLBERG, KRAVIS, ROBERTS & CO., a New York Limited Partnership, KKR ASSOCIATES, a New York Limited Partnership, and WHITEHALL ASSOCIATES, L.P., a Delaware Limited Partnership

Defendants-Appellees.

SDNY / 91-cv-5670 / MARTIN
92-7028

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[4]The Honorable Robert J. Kelleher, Senior United States District Judge for the Central District of California, sitting by designation.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York and was argued by counsel.

ON CONSIDERATION WHEREFORE, it is now hereby ORDERED, ADJUDGED and DECREED that the order of said district court be and it hereby is affirmed in accordance with the opinion of this court with costs to be taxed against the appellant.

ELAINE B. GOLDSMITH, Clerk
By:

/s/ Edward J. Guardaro
Edward J. Guardaro
Staff Attorney

§ 80b-3. Registration of investment advisers

Necessity of registration

(a) Except as provided in subsection (b) of this section, it shall be unlawful for any investment adviser, unless registered under this section, to make use of the mails or any means or instrumentality of interstate commerce in connection with his or its business as an investment adviser.

§ 80 b-5. Investment advisory contracts

(a) Compensation, assignment, and partnership-membership provisions

No investment adviser, unless exempt from registration pursuant to section 80b-3(b) of this title, shall make use of the mails or any means or instrumentality of interstate commerce, directly or indirectly, to enter into, extend, or renew any investment advisory contract, or in any way to perform any investment advisory contract entered into, extended, or renewed on or after November 1, 1940, if such contract--

(1) provides for compensation to the investment adviser on the basis of a share of capital gains upon or capital appreciation of the funds or any portion of the funds of the client;

(2) fails to provide, in substance, that no assignment of such contract shall be made by the investment adviser without the consent of the other party to the contract; or

(3) fails to provide, in substance, that the investment adviser, if a partnership, will notify the other party to the contract of any change in the membership of such partnership within a reasonable time after such change.

(b) Compensation prohibition inapplicable to certain compensation computations

Paragraph (1) of subsection (a) of this

section shall not--

(1) be construed to prohibit an investment advisory contract which provides for compensation based upon the total value of a fund averaged over a definite period, or as of definite dates, or taken as of a definite date;

(2) apply to an investment advisory contract with--

(A) an investment company registered under subchapter I of this chapter or,

(B) any other person (except a trust, governmental plan, collective trust fund, or separate account referred to in section 80a-3(c)(11) of this title), provided that the contract relates to the investment of assets in excess of $1 million,

if the contract provides for compensation based on the asset value of the company or fund under management averaged over a specified period and increasing and decreasing proportionately with the investment performance of the company or fund over a specified period in relation to the investment record of an appropriate index of securities prices or such other measure of investment performance as the Commission by rule, regulation, or order may specify; or

(3) apply with respect to any investment advisory contract between an investment adviser and a business

development company, as defined in this subchapter, if (A) the compensation provided for in such contract does not exceed 20 per centum of the realized capital gains upon the funds of the business development company over a specified period or as of definite dates, computed net of all realized capital losses and unrealized capital depreciation, and the condition of section 80a60(a)(3)(B)(iii) of this title is satisfied, and (B) the business development company does not have outstanding any option warrant, or right issued pursuant to section 80a-60(a)(3)(B) of this title and does not have a profit-sharing plan described in section 80(a)-56(n) of this title.

(c) Measurement of changes in compensation

For purposes of paragraph (2) of subsection (b) of this section, the point from which increases and decreases in compensation are measure shall be the fee which is paid or earned when the investment performance of such company or fund is equivalent to that of the index or other measure of performance, and an index of securities prices shall be deemed appropriate unless the Commission by order shall determine otherwise.

(d) Definition

As used in paragraphs (2) and (3) of subsection (a) of this section "investment advisory contract" means any contract or agreement whereby a person

agrees to act as investment adviser to or to manage any investment or trading account of another person other than an investment company registered under subchapter 1 of this chapter.

(As amended Dec. 4, 1987, Pub.L. 100-181, Title VII, § 703, 101 Stat. 1263.)

§ 80b-6. Prohibited transactions by investment advisers

It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly--

(1) to employ any device, scheme, or artifice to defraud any client or prospective client;

(2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;

(3) acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction. The prohibitions of this paragraph shall not apply to any transaction with a customer of a broker or dealer if such broker or dealer is not acting as an investment adviser in relation to such transaction;

(4) to engage in any act, practice, or course of business

which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.

Aug. 22, 1940 c. 686, Title II, § 206, 54 Stat. 852; Sept. 13, 1960, Pub.L. 86-750 §§ 8, 9, 74 Stat. 887.

§ 80b-14. Jurisdiction of offenses and suits

The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of violations of this subchapter or the rules, regulations, or orders thereunder, and concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of this subchapter or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by, or to enjoin any violation of this subchapter or rules, regulations or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 1254, 1291, 1292, and 1294 of Title 28. No costs shall be assessed for or against the Commission in any proceeding under this subchapter brought by or against the Commission in any court.

§ 80b-15. Validity of contracts

(a) Any condition, stipulation, or provision binding any person to waive compliance with any provision of this subchapter or with any rule, regulation, or order thereunder shall be void.

(b) Every contract made in violation of any provision of this subchapter and every contract heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of any provision of this subchapter, or any rule, regulation, or order thereunder, shall be void (1) as regards the rights of any person who, in violation any such provision, rule, regulation, or order, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision.

Aug. 22, 1940, c. 686, Title II, § 215, 54 Stat. 856.

§ 80a-35. Breach of fiduciary duty

(b) For the purposes of this subsection, the investment adviser of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services, or of payments of a material nature, paid by such registered investment company, or by the security holders thereof, to such investment adviser or any affiliated person of such investment adviser. An action may be brought under this subsection by the Commission, or by a security holder of such registered investment company on behalf of such company, against such investment adviser, or any affiliated person of such investment adviser, or any other person enumerated in subsection (a) of this section who has a fiduciary duty concerning such compensation or payments, for breach of fiduciary duty in respect to such compensation or payments paid by such registered investment company or by the security holders thereof to such investment adviser or person. With respect to any such action the following provisions shall apply:

(1) It shall not be necessary to allege or prove that any defendant engaged in personal misconduct, and the plaintiff shall have the burden of proving a breach of fiduciary duty.

(2) In any such action approval by the board of directors of such investment company of such compensation or payments, or of contracts or other arrangements

providing for such compensation or payments, and ratification or approval of such compensation or payments, or of contracts or other arrangements providing for such compensation or payments, by the shareholders of such investment company, shall be given such consideration by the court as is deemed appropriate under all the circumstances.

(3) No such action shall be brought or maintained against any person other than the recipient of such compensation or payments, and no damages or other relief shall be granted against any person other than the recipient of such compensation or payments. No award of damages shall be recoverable for any period prior to one year before the action was instituted. Any award of damages against such recipient shall be limited to the actual damages resulting from the breach of fiduciary duty and shall in no event exceed the amount of compensation or payments received from such investment company, or the security holders thereof, by such recipient.

(4) This subsection shall not apply to compensation or payments made in connection with transactions subject to section 17 of this title, or rules, regulations, or orders thereunder, or to sales loads for the acquisition of any security issued by a registered investment company.

(5) Any action pursuant to this subsection may be brought only in an appropriate district court of the United

States.

(6) No finding by a court with respect to a breach of fiduciary duty under this subsection shall be made a basis (A) for a finding of a violation of this title for the purposes of sections 9 and 49 of this title, section 15 of the Securities Exchange Act of 1934, or section 203 of title II of this Act, or (B) for an injunction to prohibit any person from serving in any of the capacities enumerated in subsection (a) of this section.

§ 80a-35 [Pre-1970]. Injunctions against gross abuse

The Commission is authorized to bring an action in the proper district court of the United States or United States court of any territory or other place subject to the jurisdiction of the United States, alleging that a person serving or acting in one or more of the following capacities has been guilty, after the enactment of this title and within five years of the commencement of the action, of gross misconduct or gross abuse of trust in respect of any registered investment company for which such person so serves or acts:

(1) as officer, director, member of an advisory board, investment adviser, or depositor; or

(2) as principal underwriter, if such registered company is an open-end company, unit investment trust, or face-amount certificate company.

If the Commission's allegations of such gross misconduct or gross abuse of trust are established, the court shall enjoin such person from acting in such capacity or capacities either permanently or for such period of time as it in its discretion shall deem appropriate."

§ 77m. Limitation of actions

No action shall be maintained to enforce any liability created under section 77k or 77l(2) of this title unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence, or, if the action is to enforce a liability created under section 77l(1) of this title, unless brought within one year after the violation upon which it is based. In no event shall any such action be brought to enforce a liability created under section 77k or 77l(1) of this title more than three years after the security was bona fide offered to the public, or under section 77l(2) of this title more than three years after the sale.

§ 78cc. Validity of contracts

Waiver provisions

(a) Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.

Contract provisions in violation of chapter

(b) Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this chapter or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule, or regulation: Provided, (A) That no contract shall be void by reason of this subsection because of any violation of

any rule or regulation prescribed pursuant to paragraph (3) of subsection (c) of section 78o of this title, and (B) that no contract shall be deemed to be void by reason of this subsection in any action maintained in reliance upon this subsection, by any person to or for whom any broker or dealer sells, or from or for whom any broker or dealer purchases, a security in violation of any rule or regulation prescribed pursuant to paragraph (1) or (2) of subsection (c) of section 78o of this title, unless such action is brought within one year after the discovery that such sale or purchase involves such violation and within three years after such violation. The Commission may, in a rule or regulation prescribed pursuant to such paragraph (2) of such Section 15(c), designate such rule or regulation, or portion thereof, as a rule or regulation, or portion thereof, a contract in violation of which shall not be void by reason of this subsection.